

Bell Atlantic made the following assumptions about reducing future benefit costs:⁴²

1. Both management and associate retirees' future Medicare Part B reimbursement amounts were frozen at the 1991 Part B amount.
 2. Certain future dental claim payments to dentists would be reimbursed based on current maximum dollar amounts per current fee schedules. These amounts vary by type of service.
 3. Future management retirees were assumed to share in the cost of postretirement health coverage. For management retirements after 1991, cost sharing amounts vary with respect to medical coverage for the retiree, the first dependent and all other dependents, and by calendar year. Retirees would share in cost increases over 1993 projected claims cost for their own coverage. First dependents would pay 50% of the average claims cost phased in over 20 years. Additional dependents would pay 100% also phased in over 20 years.
 4. Future associate retirees were assumed to share in the cost of postretirement health coverage. Associates who retired after 1989 were assumed to share in the cost of medical coverage beginning in 1993. The sharing amount depended on whether the retiree is younger than 65 years or older than 64 years, and whether the retiree was single or has a family.
- 14. Adjustments to Exogenous Costs to Avoid GNP-PI Double Counting.**

The Godwins Study calculated the impact of SFAS 106 on GNP-PI. This study was performed in 2 stages: (1) Actuarial Analysis and (2) Macroeconomic Analysis. The Actuarial Analysis compared SFAS-106 costs for Price Cap LECs to those an average employer will experience. The Macroeconomic Analysis determined the impact of SFAS 106 on GNP-PI. These analyses incorporated the effect the growth in medical costs

⁴² See also information provided in paragraph 12, above.

will have on GNP-PI. Therefore no further adjustment is needed to avoid double counting.⁴³

The Godwins Study determined that SFAS 106 costs would ultimately increase the GNP-PI by 0.0124%, which included the growth in medical costs. This increase is not likely to happen immediately, but to be conservative, Bell Atlantic reflected the eventual impact on GNP-PI in the first year that there could possibly be any impact.

The Godwins Study also identified a possible reduction of 0.93% in the average wage rate in the economy as a result of SFAS-106. This eventual wage reduction would affect all employers including Price Cap LECs. Any wage reductions would eventually have a downward pressure on GNP-PI and, therefore, will be reflected in rates.⁴⁴

Moreover, decreases in wage rates are by definition endogenous. Companies have some degree of control over the wages paid to their employees. As a result, no adjustment for

⁴³ The growth in medical costs is likely to have a significantly greater impact on Price Cap LECs than on the average employer for the reasons discussed above. Bell Atlantic does not propose that there should be an adjustment to the Price Cap formula to reflect this risk. The exogenous event is not the providing of postretirement benefits, but the change of accounting for these benefits.

⁴⁴ The majority of Price Cap LECs' wages are determined based on bargaining agreements. Therefore, it will be harder for Price Cap LECs to achieve these wage reductions. Price Cap LECs also are capital intensive businesses. Compared to the average employer, therefore, wages are a smaller percentage of total costs. As a result, the average employer is likely to benefit more from the drop in the national average wage rate than are the Price Cap LECs.

this endogenous item should be made in determining the amount of SFAS 106 costs to be given exogenous treatment.⁴⁵

15. Description and Documentation of Macroeconomic Model Used in the USTA Study.

Attached to this direct case is Bell Atlantic's Transmittal No. 497, which included the Godwins Study. The Godwins Study describes the method of estimation, parameter estimates, and summary statistics, and includes sensitivity analyses. Godwins has also provided additional information on the macroeconomic model and its calibration. Attachment E is the additional information provided by Godwins.

CONCLUSION


Bell Atlantic has demonstrated that the costs resulting from SFAS 106 are exogenous, and has filed with the Commission tariffs

⁴⁵ For example, if Bell Atlantic increases wages this year, Bell Atlantic could not receive exogenous treatment for these wage increases. Conversely, if Bell Atlantic decreases wages, this decrease would increase productivity. If Bell Atlantic achieves a productivity gain that results in Bell Atlantic earning greater than 12.25% rate of return, Bell Atlantic is required to share with customers a portion of this productivity gain.

appropriately reflecting those costs. The Commission should approve Bell Atlantic's tariffs.

Respectfully submitted,
The Bell Atlantic Telephone
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June 1, 1992

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing "Direct Case of Bell Atlantic" was served this 1st day of June, 1992, by delivery thereof by first class mail, postage prepaid, to the parties on the attached list. An asterisk (*) indicates that the attachments to this document have been served upon the parties so designated under seperate cover.


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ATTACHMENT A

CREDIT DECISIONS

Volume 9 Number 11

March 23, 1992

SFAS 106 And Its Impact On Utility Credit Quality

In December 1990, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" or "PBOPs." SFAS 106 applies to all PBOPs but focuses primarily on health care. The FASB considers that PBOPs should receive the same recognition as a pension commitment.

Although the liability has always existed, a disclosure in utility financial statements will shed a much brighter light on this item by 1993. SFAS 106 must be adopted no later than fiscal years beginning after December 15, 1992. Utilities are in the situation, unlike other companies, of having to recover PBOPs costs in rates. Therefore, the credit quality may be either positively or negatively affected depending on each utility's regulatory support.

What is SFAS 106?

Although the FASB wants PBOPs treated like pension benefits, medical costs are less predictable and increasing much faster than the wages which dictate pension payments. The characteristics of the workforce or low employee turnover in some industries could add to companies' financial burden. In an attempt to lower costs, utilities and other companies are looking at ways to shift more of the burden onto employees and retirees by capping benefit contributions, or by offering employees various plans for them to accumulate funds to meet retirement medical costs. Some companies have terminated medical coverage for new retirees.

Because utilities have unionized workers, a revised benefits package has to be part of contract negotiations. Company sponsored retiree medical coverage may be eliminated for more employees, particularly as there are changes in national health care policy.

While SFAS 106 provides for liability recognition, funding for the liability remains a question. The various funding plans being studied for health care coverage include Voluntary Employees Beneficiary Association (VEBA) and other tax advantaged 501(c) trusts, 401(h) accounts, and corporate-owned life insurance. Nonetheless, the ability to fund the PBOPs liability on a tax-advantaged basis, similar to pensions, currently appears to be limited.

The new accounting standard requires that the utility adopt the accrual method to establish a reserve for PBOPs costs incurred for participants' prior benefits. The employer must fully accrue an employee's PBOPs obligation before the employee is eligible to receive these benefits. Companies will be required to disclose the expected PBOPs obligation based on the present value of anticipated benefit payments to be paid to employees after retirement. Utilities, and most other companies, currently recognize these costs only on a

cash, or "pay-as-you-go," basis as claims are actually paid for the retired employee.

When a company adopts SFAS 106, it must then book a liability calculated as the present value of all future PBOPs accrued and unfunded for retired and current employees. SFAS 106 proposes to allow this accrued benefit obligation, or "transition obligation," to be booked immediately or amortized over the shorter of the average remaining service period of current employees or 20 years. Cash outlays for postretirement benefits will not change, but the annual expense to be recognized for financial reporting purposes will increase.

Utility Regulation and SFAS 106

For utilities, the impact of SFAS 106 on financial results will depend on regulatory treatment. Following are the three potential regulatory scenarios:

- (1) The preferred option is approval to recover the accrued costs in current rates and contribute

(Cont. on Page 6)

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REGULAR FEATURE

D&P Rating Watch Insert

March 23, 1992

LATEST RATING ACTIONS

As we went to press with this issue, the following rating actions were taken; more details will be provided in a future issue of *Credit Decisions*.

Rating Changes

Company	Rating Action	Security Class	From	To
Gulf States Utilities Co.	Upgrade	FMB Pfd. Stock	BBB- DP	BBB BB+

New Ratings/New Issues/Rating Watch/Reaffirmation/Withdrawal

Company	Rating Action	Security Class	Rating
BankAmerica Corp.	New Issue	Notes	A
Boatmen's Bancshares, Inc.	Rating Watch—Unfavorable	Sub. Debt	A-
Boatmen's National Bank of St. Louis	Rating Watch—Unfavorable	Long-Term CDs	A+
Citicorp	New Issue	Pfd. Stock	BBB-
Delta Air Lines	New Issue	Notes/Debs.	BBB
Gulf States Utilities Co.	New Rating Reaffirmation	Debs./PCRB (NCol.) Pfc. Stock	BBB- DP
Houston Lighting & Power	New Issue	FMB/MTN	A+
		Cum. Pfd. Stock (Shelf)	A
	Reaffirmation	FMB/Sec. MTN/PCRB (Col.)	A+
		PCRB (NCol.)/Pfd. Stock Comm. Paper	A Duff 1
Idaho Power Company	New Issue	FMB	A+
Procter & Gamble	New Issue	Notes	AA
Stone Container Corp.	New Issue	Sr. Sub. Notes	B+
Wisconsin Power & Light Co.	New Issue	F&RMB	AA

FIXED INCOME UPDATE

Following is a compilation of recent developments. The event may cause a changing trend in risk but it would not be outside the range satisfactory for the current D&P rating. Further, the implication is not necessarily sufficient to warrant a Rating Watch addition.

Company	Rating	Implication	Company	Rating	Implication
Arkansas Power & Light Union Electric	BBB A+	Expected Expected	and adjustment and incentive mechanisms that, if accomplished, would permit returns of up to 12% on equity. The equity ratio would be raised to 52%, an important positive. The settlement includes an electric revenue adjustment mechanism (ERAM) which would remove earnings effects of variability in weather and sales forecasts.		
Union Electric completed purchase of AP&L's Missouri properties. The transaction, valued at \$63 million, will add approximately 26,000 customers to Union Electric's customer base.					
Black & Decker Corp.	BB	Positive	Dayton Hudson Corp.	A+	Positive
Black & Decker plans to raise \$750-780 million to pay down a portion of its \$2.6 billion of long term debt. In two offerings, Black & Decker will sell all of the stock in its information and service business: PRC Advanced Systems Inc. (for proceeds of \$330-360 million) and offer 18 million common shares of its own stock (expected to raise about \$420 million).			DH will eliminate 630 positions (half are management posts) and close a Minneapolis and possibly a Detroit warehouse. These actions primarily affect employees at 19 Dayton's and 23 Marshall Field's stores, but will impact just 2% of DH's 34,000 employees.		
Consolidated Edison of NY	AA-	Positive	General Electric Company	AA+	Negative
The New York PSC approved in principle a three-year electric rate settlement reached in January with the Commission staff. The PSC sent the plan back to the parties with certain modifications made by the Commission, including one to levelize the rate increases for the term of the plan. The settlement authorizes revenue increases			The Justice Department charged GE with fraudulently diverting U.S. government funds earmarked for Israeli military jet engines to an Israeli general. In a suit recently amended in Cincinnati federal court, the amount of alleged fund diversion was raised to \$40 million from the \$30 million previously documented. GE said it has initiated disciplinary action against 20 top managers of its aircraft engine unit in connection with this case. Impact on future government contracting is uncertain at this time.		

FIXED INCOME UPDATE

(Cont.)

Company	Rating	Implication
Kansas Gas & Electric Kansas Power & Light	BBB+ AA-	Uncertain Uncertain
Merger of KP&L with KG&E has been delayed pending analysis of sounds heard at the Wolf Creek nuclear station of which KG&E has a 550 mw share. The merger had been scheduled to occur on March 16.		
KeyCorp	A-	Neutral
KeyCorp will buy the \$4.9 billion Puget Sound Bancorp in a \$800 million stock swap. With this acquisition, KeyCorp will increase its market share in the Seattle/Tacoma Washington area to 8.3% from 1.3%, making it third largest. The new combined entity will be called Key Bank of Washington.		
MCI Communications	BBB+	Positive
MCI has been awarded a 10-year contract valued at \$558 million to provide air traffic control communications links to the FAA.		
Pfizer Inc.	AA	Negative
The U.S. Food and Drug Administration asked Pfizer to warn recipients of its larger 60 degree Shiley heart valves that the risk of fracture is up to five times higher than previously estimated. An FDA official		

Company	Rating	Implication
said that the fracture risk for its 23,000 U.S. and Canadian patients might be great enough to warrant replacing these valves in some individuals.		
Public Service Co. of New Mexico	BBB-	Positive
PSNM signed a three-year agreement to sell power to Imperial Irrigation District of California. Under the agreement, PSNM will provide 56 mw of base demand year-round, and an additional 25 mw of seasonal demand from April through October.		
Sierra Pacific Power	A-	Positive
Parent filed shelf for 1.5 million of common shares. A portion of proceeds are expected to be used for debt repayment and additional equity investment in its subsidiaries.		
Southwestern Bell	A+	Positive
SWBT reached agreement with Communications Workers of America which would eliminate up to 1,000 jobs by year-end through early retirement offers to union employees. The jobs are part of the 2,000 identified by SWBT as surplus, more than half of which are expected to be eliminated through early retirement.		

RATING UPGRADE

	Security Class	From	To	Mdy's/S&P	Fixed Obligation Ratio		Fixed Charge Coverage	
					1991E	1992E	1991E	1992E
The Dayton Power & Light Company	FMB/PCRB (Col.)	BBB+	A+	A2/A	48%	48%	2.2X	2.5X
	Debs	BBB+	A	A3/A-				
	Pfd. Stock	BBB	A	"a2"/A-				

We have raised the ratings of Dayton Power & Light Company's first mortgage bonds and collateralized pollution control revenue bonds to 'A+' from 'BBB+', debentures to 'A' from 'BBB+', and preferred stock to 'A' from 'BBB'. Dayton Power & Light's financial protection measures and cash flows are expected to improve significantly with the implementation of recent electric, gas, and steam rate settlements. The company was allowed to increase electric revenues approximately \$129 million under a three-year phase-in plan to recover Zimmer costs. With the 1991 completion of the 1300 mw Zimmer coal plant (365 mw interest for Dayton), construction will return to more manageable levels. Spending will largely reflect the addition of new peaking

capacity and demand side management programs. The company's acid rain requirements are minimal and will center on fuel-switching. Dayton Power & Light is a low-cost energy producer and has well-maintained, efficient plants. Management strategy has been effective in positioning the company for the risks the industry faces. Dayton Power & Light Company, the principal subsidiary of DPL Inc., provides electric, natural gas, and steam service in a 6,000 square mile area of west central Ohio.

March 23, 1992

RATING UPGRADE/NEW ISSUE

	Security Class	From	To	Mdy's/S&P
Massachusetts Municipal Wholesale Electric Company	Bonds	BB+	BBB+	Baa1/BBB

We have raised the rating of Massachusetts Municipal Wholesale Electric Company's (MMWEC) revenue and refunding bonds and non-defeased portions of 1981 Series B and 1982 Series A bonds to 'BBB+' from 'BB+'. The securities are removed from Rating Watch — Favorable. A rating of 'BBB+' is also assigned to MMWEC's proposed sale of \$284 million of power supply system revenue bonds, the first installment of an expected \$730 million ongoing refunding program. The refunding program will significantly lower MMWEC's debt service requirements. Substantial savings to members will result in more competitive rates. The legal status of the power sales agreements (PSAs) with its Massachusetts participants, which secure MMWEC's debt obligations, has been strengthened. A favorable Massachusetts Supreme Court decision in 1991 affirmed the validity of the Massachusetts' participants Project 6 power sales agreements with MMWEC and that MMWEC properly invoked the step-up provisions under these agreements. Appellant's petition for a writ of certiorari and other attempts to review the Massachusetts Supreme Court decision have been denied by the U.S. Supreme Court. There have also been

favorable developments regarding the validity of the PSAs of the Massachusetts participants in the arbitration proceedings emanating from the Hull Municipal Lighting Plant litigation. Several of the remaining counts in the arbitration proceedings and some of the issues that may be addressed in any future litigation of the Massachusetts Supreme Court decision have been adjudicated in favor of MMWEC in other court proceedings. In upgrading MMWEC's rating, we relied upon the opinion of Bond Counsel (Mudge Rose), Bond Counsel's evaluation of the validity of the Massachusetts PSAs, and the assessment by MMWEC and counsel of the expected future favorable resolution of challenges to the validity of the PSAs. In its examination of all major litigation involving the PSAs, Bond Counsel did not find anything that would suggest that these obligations were not valid and binding upon the Massachusetts participants. Importantly, based on court opinions to date, opinions of counsel, and other considerations, MMWEC believes it is highly probable that it will be successful in defending against the rescission of the Massachusetts PSAs in response to outstanding claims.

RATING DOWNGRADE/RATING REAFFIRMATION

					Debt		Pretax Interest	
Security Class		From	To	Mdy's/S&P	Ratio		Coverage	
					1991E	1992E	1991E	1992E
US WEST, Inc.	Cv. Sub. LYONs	A+	A	A3/A	50%	50%	2.9X	3.0X
US WEST Capital Funding, Inc.	Sr. Unsec. Debt	AA-	A+	A2/A+				
US WEST Communications, Inc.	Sr. Unsec. Debt	-	AA	Aa3/AA-				
US WEST Financial Services, Inc.	Sr. Unsec. Debt	AA-	A+	A2/A+				

In addition to reaffirming the 'AA' rating of US WEST Communications, Inc.'s long-term senior unsecured debt and lowering the ratings of the non-regulated subsidiaries' long-term debt, we have reaffirmed the Duff 1+ commercial paper ratings of US WEST, Inc. and all of the above subsidiaries. These rating actions reflect the deterioration of US WEST's consolidated creditworthiness as a result of problems in US WEST's real estate operations. US WEST has been attempting to exit the real estate business and has established \$400 million in reserves to cover anticipated losses during the liquidation period. US WEST, Inc. is directly or indirectly ultimately responsible for over \$1 billion of real estate

related debt. In addition, US WEST has agreed to support approximately \$2.5 billion of US WEST Financial Services' debt and unconditionally guarantees the debt of US WEST Capital Funding, currently about \$500 million. US WEST, Inc.'s LYONs, with a current accreted value of \$400 million, are subordinate to all other debt of US WEST and its subsidiaries. The ratings also reflect the dividends US WEST receives from subsidiaries, principally US WEST Communications, that are available for support requirements and to honor guarantees. However operating subsidiaries' creditors have a prior claim on subsidiary earnings, dividends and assets.

The Duff & Phelps Rating Watch

March 18, 1992

Issuer (Date placed on Rating Watch)	Credit Rating Trend	D&P	Moody's/S&P	Reason for Rating Watch Addition
American Pioneer Savings Bank - Mtg. Backed Bonds (2/90)	Down	AAA	NR/NR	Uncertainty regarding RTC takeover of American Pioneer
Apache Corp. (5/91)	Down	Sub. BBB-	Ba3/BB+	Increased leverage and lower coverages due to recent acquisition of Amoco properties
Avco Financial Services (8/90)	Up	A-	A2/A	Improving financial performance
Bethlehem Steel Corp. (2/92)	Down	BB	Ba3/BB	Diminished financial strength & weakness in steel environment
Black & Decker Corp. (3/92)	Up	BB	Ba2/BB	Potential of debt reductions via equity offerings
Boatmen's Bancshares, Inc. (3/92)	Down	A-	A3/A-	Concerns regarding pending acquisition of Sunwest Financial Services
Boatmen's National Bank of St. Louis (3/92)	Down	A+	Aa3/A+	(See Boatmen's Bancshares)
Campbell Soup Co. (12/90)	Down	AA	Aa2/AA	Potential for increased financial leverage
Caterpillar Inc. (12/91)	Down	A-	A3/A-	Further financial difficulty likely due to continuation of strike
Centel Corporation (1/92)	Up/Down	BBB-	Baa3/BBB-	Will explore alternatives, including possible sale of company, to maximize shareholder value
Centel Capital Corporation (1/92)	Up/Down	BBB-	Baa3/BBB-	(See Centel Corp.)
Central Telephone Company (1/92)	Up/Down	A+	A1/A	(See Centel Corp.)
Central Telephone Co. of Florida (1/92)	Up/Down	A+	A2/A+	(See Centel Corp.)
Central Telephone Co. of Illinois (1/92)	Up/Down	AA	A1/A+	(See Centel Corp.)
Central Telephone Co. of Virginia (1/92)	Up/Down	AA	A2/A+	(See Centel Corp.)
Coltec Holdings Inc. (1/92)	Up	B-	B2/B-	Proposed recapitalization plan
Coltec Industries Inc. (1/92)	Up	BB-	Ba3/B	(See Coltec Holdings)
Comerica (11/91)	Up	Sub. A-	A3/BBB+	Benefits from proposed merger with Manufacturers National Corp.
Comerica Bank-Detroit (11/91)	Up	A+	Aa3/A	(See Comerica)
Consumers Power Co. (7/91)	Up	BBB+	Baa2/BBB	Anticipated use of MCV proceeds for debt repayment will strengthen financial measures
Comdisco, Inc. (3/92)	Down	A-	Baa2/BBB+	Pressure on profits due to increasing competitive environment
Corning Inc. (2/92)	Down	AA-	A2/A+	Potential financial impact from Dow Corning's legal problems
Dow Corning Corporation (1/92)	Down	AA	A3/A	Potential adverse legal and economic consequences from alleged safety problems with silicone breast implant products
E.I. du Pont de Nemours (4/91)	Down	AA-	Aa2/AA	Diminishing returns in most segments due to cyclical downturn
Empbanque Financial Services, Inc. (1/92)	Down	BBB+	NR/NR	Higher than expected delinquencies/foreclosures in mortgage pools
Equitable Life Assurance Society of the U.S. (10/91)	Up	CPA A	A3/A	Finalization of agreement with AXA Group and expected demutualization
Equitable Variable Life Insurance Co. (10/91)	Up	CPA A	A3/A	(See Equitable Life Assurance Society of the U.S.)
Forest Oil Corp (5/91)	Down	B-	Caa/CCC	Proposed exchange offer to restructure its debt and preferred stock
General Dynamics Corp. (10/91)	Down	BBB	Baa1/A-	Asset sale and program to enhance shareholder value
Green Tree Acceptance Corp. (3/92)	Up	Sr. Sub. BB-	Ba3/BB-	Settlement of lawsuit; selling equity
Grumman Corp. (3/92)	Up	BBB-	Baa3/BBB-	Debt reduction and improving liquidity
GTE Florida Inc. (1/92)	Down	AA-	Aa3/AA-	Financial protection measures may fall short of expectations
Gulf States Utilities (5/91)	Up	Ptc. DP	"ba3"/BB	Improved prospects for payment of dividend arrearages
IBM Corp. (12/91)	Down	AA+	Aa2/AAA	Continued weak operating performance & aggressive expansion of customer financing
Iowa Power Inc. (6/91)	Up	A-	A2/A	Pending merger of Iowa Power and Iowa PS into single utility
Iowa Public Service Co. (6/91)	Down	A+	A1/A+	(See Iowa Power)
Kansas Gas & Electric (7/90)	Up	BBB+	Baa1/A-	Quality of debt may improve with merger
Kansas Power & Light (10/90)	Down	AA-	Aa3/A-	Proposed merger with KG&E would increase leverage
Magma Copper (1/92)	Up	Sr. Sub. B+	Ba3/BB-	Successful refinancing efforts
National City Corp. (10/91)	Down	AA-	A1/A	Definitive agreement to acquire Merchants National Corp.
BancOhio National Bank (10/91)	Down	AA-	Aa3/A+	(See National City Corp.)
First Kentucky National Corp. (10/91)	Down	AA-	A1/A	(See National City Corp.)
First Nat'l. Bank of Louisville (10/91)	Down	AA-	Aa3/A+	(See National City Corp.)
National City Bank (10/91)	Down	AA	Aa3/A+	(See National City Corp.)

• Denotes new addition.

Side A

The Duff & Phelps Rating Watch

March 18, 1992

Issuer (Date placed on Rating Watch)	Credit Rating Trend	D&P	Moody's/S&P	Reason for Rating Watch Addition
NCR Corp. (12/90)	Up	AA-	Aa3/AA	Possible guarantee by financially stronger AT&T
Orange & Rockland Utilities (12/91)	Down	AA-	A2/A+	Adverse gas rate decision
Pfizer Inc. (2/92)	Up	AA	Aaa/AAA	Possible elimination of major liabilities stemming from Shiley heart valve failures
Portland General Electric (10/91)	Down	A	A3/A-	Ability of Trojan to operate on a sustained basis
Reynolds Metals Co. (12/90)	Up	BBB+	Baa1/BBB+	Positive fundamental developments have strengthened capital structure
Salomon Inc. (8/91)	Down	A+	A3/A	Legal, financial and organizational problems could result from Treasury bid violations
Security Pacific Corp. (8/91)	Up	BBB+	A3/A-	Merger with BankAmerica would enhance credit quality
Arizona Bancwest (10/91)	Up	Sub. BBB	Ba1/BBB+	(See Security Pacific)
Ranier Bancorporation (10/91)	Up	Sub. BBB	NR/NR	(See Security Pacific)
Security Pacific Bank Arizona (8/91)	Up	A-	NR/A	(See Security Pacific)
Security Pacific Bank of Washington (8/91)	Up	A	A1/A	(See Security Pacific)
Security Pacific National Bank (8/91)	Up	A-	A1/A	(See Security Pacific)
Sequa Corp. (8/91)	Down	BBB	Ba1/BB+	Asset quality deterioration at Sequa Finance
Society Corp. (9/91)	Down	A	A3/A	Announcement to acquire Ameritrust Corp.
Society National Bank (9/91)	Down	A+	A1/A	(See Society Corp.)
Texaco Inc. (3/91)	Up	A	A1/A+	Expectations for further improvement in balance sheet
Texaco Capital Inc. (3/91)	Up	A	A1/A+	(See Texaco Inc.)
Texas-New Mexico Power (7/91)	Down	BB	Ba2/BB-	Uncertain regulatory environment
Transco Energy (9/91)	Down	BBB-	Ba1/BB+	Potential refunds related to FERC transition cost proceeding
Transcontinental Gas Pipe Line (9/91)	Down	BBB	Baa3/BBB-	(See Transco Energy)
Tucson Electric Power Co. (7/91)	Up/Down	B-	B3/B	Ability to restructure including necessary approvals following dismissal of petitions for involuntary reorganization
Wells Fargo & Co. (12/91)	Down	A-	Baa1/A-	Concerns for deterioration in real estate loan portfolio
Crocker National Corp. (12/91)	Down	A-	Baa1/NR	(See Wells Fargo)
Wells Fargo Bank, N.A. (12/91)	Down	A	A2/A	(See Wells Fargo)
Westinghouse Electric Corp. (12/91)	Down	BBB+	Baa2/A	Financial distress due to poor quality loan portfolio at Westinghouse Credit
Westinghouse Credit Corp. (12/91)	Down	BBB+	Baa2/A	(See Westinghouse Electric)
Deletions				
Issuer (Date placed on Rating Watch)	Credit Rating Action	D&P Ratings From To	Moody's/S&P Ratings	Reason for Rating Watch Deletion
Gulf States Utilities (5/91)	Upgrade	Pfd. DP BB+	"ba1"/BB	Payment of preferred dividend arrearages
Massachusetts Muni. Whst. Electric (8/91)	Upgrade	BB+	Baa1/BBB	Strengthened legal status of PSAs with Massachusetts participants

• Denotes new addition.

Side B

NEW RATING

	Security Class	Rating	Mdy's/S&P	Return On Assets		Leverage	
				1991E	1992E	1991E	1992E
Meridian Bancorp, Inc.	Sr. Debt	A-	NR/BBB+	0.96%	1.00%	14.0X	13.5X
	Sub. Debt	BBB+	Baa1/BBB				
	Pfd. Stock	BBB	NR/NR				
Meridian Bank	Long-Term Deposits	A	A1/A-				
	Ctfs. of Deposits	Duff 1	P-1/A-2				

New ratings have been assigned to Meridian Bancorp, Inc., and its principal subsidiary, Meridian Bank. The ratings reflect Meridian's above average capitalization, strong reserves, improved liquidity, and conservative parent company structure. These positives are offset to an extent by a deterioration in loan quality measures resulting in above average loan loss provisioning in 1990 and 1991 which negatively affected earnings. Meridian reported fourth quarter 1991 earnings of \$24.2 million which was a return on assets of 0.87% compared with \$18.6 million, 0.67%, in 1990. Full year 1991 net income was \$100.6 million, 0.96% ROA. Earnings have been restrained by high loan loss provisions; however, Meridian's fundamental earnings power, as measured by pre-tax income before credit expenses and nonrecurring items, was a respectable 2.04% of average assets in the fourth quarter. Growth in a number of fee-based businesses has contributed to Meridian's solid core earnings performance. Meridian significantly strengthened its balance sheet during 1991 as capital measures grew and loan loss reserves increased. Stockholders' equity equaled 7.12% of assets at December 31, 1991, compared with 5.80% one year earlier, while the total risk-based capital ratio was 10.01% up from 7.95%. The loan loss reserve was \$165 million or 2.23% of loans at yearend 1991 and 109% of nonperforming loans. Asset quality has deteriorated during this period of economic weakness and real estate market instability. Nonperforming assets equaled 2.98% of loans and Other Real Estate Owned at December 31, 1991, compared with 2.55% and 1.97% at September 30, 1991, and

December 31, 1990, respectively. Net charge-offs have also been above historical levels recently. Fourth quarter net charge-offs equaled \$25.0 million, an estimated 1.30% of average loans annualized. While asset quality measures have weakened, the deterioration has slowed and additional significant deterioration is not expected. On a relative basis, Meridian's loan portfolio has performed favorably given nonperforming and charge-off levels of other regional competitors. Meridian is in the process of implementing recommendations resulting from a comprehensive review of its operations, including products, services, and staffing. Management expects expense reductions and revenue enhancements of between \$15 million and \$20 million, annually. One area of focus has been an expansion in its core deposit gathering capabilities in eastern Pennsylvania. The RTC-assisted acquisition of Hill Financial significantly reduced the dependence on wholesale funding. The recent acquisition of Liberty Bank branches and \$300 million in deposits continues this strategic initiative. Securitization and other loan sales have also positively impacted liquidity. Meridian has entered into an agreement to sell its title insurance operations, expected to be consummated by midyear 1992, which has been a major drag on earnings over recent years. The growth in capital and reserves during 1991 should provide Meridian with the flexibility to effectively resolve problem assets as well as take advantage of opportunities to grow its regional franchise and other lines of business. Lastly, liquidity has been enhanced by growing core deposits while reducing wholesale funding reliance.

NEW ISSUE

	Security Class	Rating	Mdy's/S&P
Los Angeles Department of Water and Power	Elec. Rev. Bonds	AA	Aa/AA

A rating of 'AA' has been assigned to the Los Angeles Department of Water and Power's (the Department) \$150 million of electric plant revenue bonds, Issue of 1992. Proceeds will be used for the Power System's ongoing construction program. The Department's Power System has maintained a conservative capital structure and strong debt service coverages. The Department is under the direction of a five-member Board which is obligated by charter to set rates at levels sufficient to meet all expenses, including debt service requirements. Generating capacity is diversified through wholly-owned oil/gas units in the service area, ownership shares in projects in Arizona and Nevada, and power purchases. A well-developed transmission network facilitates power imports from the desert areas and the Pacific Northwest.

The Department's purchased power entitlement represents the largest participation in the Intermountain Power Project, a large Utah coal plant. The Power System's Intermountain and other purchased power commitments represent large off balance sheet liabilities and impact debt service coverages. Construction expenditures have begun to accelerate as expected. The Power System will repower some of its older steam units in order to comply with strict environmental and clean air standards in California. As most new capacity and energy will come from sources outside California, the Power System is also studying several projects involving expansion of its transmission system and new capacity additions in other states.

NEW ISSUE (Cont.)

	Security Class	Rating	Mdy's/S&P	Return On Assets		Leverage	
				1991E	1992E	1991E	1992E
Merrill Lynch & Co., Inc.	Notes	AA-	A1/A+	20.7%	18.0%	20X	20X

We have assigned a rating of 'AA-' to Merrill Lynch's \$300 million issue of 6¾% notes due March 5, 1995. The rating assigned to this issue is the same as that assigned to Merrill Lynch's outstanding senior debt. The rating reflects Merrill Lynch's (MER) return to solid profitability in 1991 and our expectation that profitability measures will remain above the depressed levels of the prior several years. MER's net earnings for 1991 advanced an impressive 263% to \$696 million primarily reflecting improved market conditions but also successful implementation of cost control measures. Most notably, investment banking revenues rose 48% in 1991 while principal transaction revenues increased 31% and commission revenues grew by 22%. Non-interest expenses increased 13%. Excluding volume-related

expenses, however, operating expenses declined 3%. MER has sought to reduce the volatility inherent in the securities business by emphasizing products that generate ongoing fee income and contribute to long-term customer relationships. MER's diversification and leadership position within the industry are important positives. MER's asset base is high quality and very liquid, and leverage is reasonable. Merrill Lynch & Co., with 1991 revenues of \$12.4 billion, provides a complete line of investment, financing, insurance, and related services.

SFAS 106 And Its Impact On Utility Credit Quality (Cont. from Page 1)

these funds to an external trust which would offset the liability to be recorded.

- (2) The second option is the assurance of future rate recovery whereby the accrued costs are deferred, establishing a regulatory asset under SFAS No. 71 to be amortized later as the costs are paid out. According to SFAS 71, a company may capitalize an incurred cost as a regulatory asset if regulators can provide reasonable assurance for recovery of such cost in future revenues.
- (3) The third possibility (not anticipated) would be that full recovery of accrued expenses is not permitted nor is an SFAS 71 asset created, in which case reported earnings would be reduced.

How Will PBOPs Costs Be Paid?

Few industrial companies are prefunding the PBOPs liability. There has been limited tax incentive to do so, contrary to that available for the pension fund liability. Management must consider its obligation to provide benefit security to retirees. There is little security without prefunding. Although prefunding will not be required, SFAS 106 is expected to encourage the prefunding effort, particularly for utilities as a regulated industry. Commissions would be more likely to allow the recovery of PBOPs expenses if the utilities were setting aside the funds in a separate trust.

Historically, utility regulators have steadfastly maintained that today's customers should not pay for benefits for future customers. The reverse should also be true — future customers should not pay the costs belonging to past customers. This argument forms a reasonable basis for allowing the collection of accrued PBOPs costs. The employer's obligation for postretirement benefits represents deferred compensation, a cost incurred during an employee's time of employment.

The impact on long-term customer rates can be mitigated by authorizing recovery of accrued costs

beginning now rather than adding these costs to other rising costs in the future. In addition, costs over the long run will be offset, in part, by the accumulation of PBOPs fund earnings. Without prefunding, the accrued expenses would result in continued growth in the amount of the unfunded liability. If such expenses are prefunded, the corresponding asset also will increase.

Initial Responses to SFAS 106

If quantifiable, companies will disclose the SFAS 106 PBOPs liability prior to its adoption. As a result, the financial impact may be known before the 1993 deadline. A December 26, 1991, FCC order for telephone companies authorized adoption of SFAS 106 on or before January 1, 1993, and required amortization of the past obligation for regulatory purposes. For financial reporting purposes, telcos are not precluded from one-time recognition of the total past obligation. Most companies are likely to wait until 1993 to fully adopt SFAS 106, particularly utilities which must file for regulatory recognition of costs in rate proceedings. Actuarial studies and various assumptions regarding employee characteristics and the future status of health care policies vary greatly. These differences will make it difficult to analyze this liability and its related expenses and to make comparisons between companies.

Commonwealth Edison (CWE) has been accruing and prefunding a portion of its estimated PBOPs liability through a trust fund since 1980. CWE recovers these accrued costs in rates. As a result, the initial impact of adoption of SFAS 106 on CWE will be moderated, but the ultimate effect will depend on future rate treatment. The Southern Company also has partially prefunded its accrued PBOPs costs to the extent deductible under federal income tax law. Several other companies have been allowed similar treatment.

In late 1991, Duke Power received regulatory recognition of SFAS 106 costs in rate orders in North Carolina and South Carolina. Those state commissions approved inclusion of Duke's accrued PBOPs expense in its cost of service as a "known and measurable" operating expense. Other states currently are looking at

(Cont. on Page 7)

SFAS 106 And Its Impact On Utility Credit Quality (Cont. from Page 6)

PBOPs and are anticipated to have generic hearings on this issue.

What Are the Credit Quality Implications?

The full impact of adoption of SFAS 106 upon credit ratings is uncertain until rate treatment is determined by regulators. Regulatory recognition of PBOPs should be comparable to that for pensions and for nuclear decommissioning. The liability has been known, but the magnitude is greater than expected for many companies.

Absent a revenue increase or deferral of costs as a regulatory asset under SFAS 71, the PBOPs accruals would lower reported net income but not immediate cash flow. Assuming that a regulatory commission permits recovery or authorizes deferral of the accrued PBOPs expenses, then net income would not be adversely affected. In addition, recovery of the accrued costs would allow utilities to prefund these costs. Without prefunding of PBOPs costs or the establishment of a firm regulatory asset, a major concern becomes the capital ratios to be used to establish rates of allowed returns and the ultimate earnings level of the utility.

Current revenue recognition of the postretirement liability reduces the risk of future recovery being denied

by regulators when these costs would reach even larger proportions. We have no indication, as yet, that regulators will not continue to allow recovery of these costs as they are now on a pay-as-you-go basis. However, regulatory practices often are unpredictable or inconsistent.

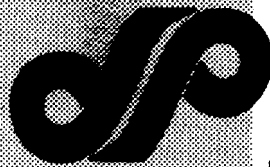
Assuming adoption of SFAS 106 for ratemaking purposes and ongoing cash recovery for prefunding of PBOPs costs, the credit posture of that utility would be affected positively. The absence of full recovery of such costs would leave the utility with the question of having an increasing unfunded PBOPs liability and the risk of recovery in the future. Equally important, the latter utility's future competitive position will diminish as it raises prices to cover costs which were recovered by the prefunding utility earlier and as incurred.

In summary, credit ratings will be favorably impacted in those situations where companies are granted revenues currently. The credit implication is negative where the reported PBOPs liability is greater than had been anticipated, resulting in a very large future obligation. Clearly, any commission reluctance to recognize the full obligation under SFAS 106 would be a negative.

William A. Abrams, CFA
Mary Beth McGirr

Duff & Phelps Credit Rating Co.

Chicago ■ New York



The utility industry faces increased competition. Following a pattern set for telephone and gas utilities, legislation is being considered to change the rules for electric utilities. As all utilities operate in an increasingly changing environment, most are entering the financial markets for plant expansion, system upgrades and refunding.

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ATTACHMENT B

UNITED STATES TELEPHONE ASSOCIATION

Analysis of Impact of FAS 106 Costs on GNP-PI

February, 1992

The logo for Godwins, featuring the word "Godwins" in a stylized, cursive script. It is positioned in the bottom right corner of the page, partially overlapping a decorative graphic of two parallel diagonal lines that run from the bottom left towards the top right.

Godwins

UNITED STATES TELEPHONE ASSOCIATION
Analysis of Impact of SFAS 106 Costs on GNP-PI

February 18, 1992

Godwins

BACKGROUND


Godwins has been engaged by the United States Telephone Association to perform an analysis of the impact of SFAS 106 on the GNP-PI. In particular, Godwins was asked to determine the extent to which the price cap mechanism utilized by the FCC will reflect the impact of SFAS 106 and will enable Local Exchange Carriers to recover their increase in total operating costs incurred due to their adoption of the new accounting standard.

This report describes the results of that analysis and provides detailed documentation of the data, methods, and assumptions utilized in the study.

Respectfully submitted,



Peter J. Neuwirth, F.S.A., M.A.A.A.



Andrew B. Abel, Ph.D.

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I. EXECUTIVE SUMMARY

The purpose of this study is to determine what percentage of the additional costs incurred by Local Exchange Carriers subject to Federal Price Cap regulations (hereinafter referred to as "Price Cap LECs") as a result of the Financial Accounting Standards Board's Statement No. 106 (SFAS 106) will be reflected in the GNP Price Index (GNP-PI) and what percentage will not be so reflected.

This study finds that ultimately the increase in GNP-PI caused by SFAS 106 (.0124%) will provide for recovery of 0.7% of the additional costs incurred by Price Cap LECs. Other macroeconomic factors, principally an eventual adjustment of the national wage rate, account for recovery of an additional 14.5% of the additional costs incurred by Price Cap LECs, leaving 84.8% of these additional costs unrecovered.

This study is presented in two stages: an Actuarial Analysis followed by a Macroeconomic Analysis. The Actuarial Analysis uses demographic, economic and benefit program data collected from each Price Cap LEC to construct a composite company (hereinafter referred to as "TELCO") which reflects the characteristics of the industry as a whole. This analysis finds that the impact of SFAS 106 on the costs of the average employer in the economy is only 28.3% of the corresponding impact on TELCO. The Macroeconomic Analysis which analyzes the impact of SFAS 106 on the economy as a whole finds that only 2.3% of the average employer's additional costs resulting from SFAS 106 is passed through to the GNP-PI.

The table on the following page summarizes how the key results of the study are combined to derive the unrecovered proportion of the Price Cap LECs' SFAS 106 costs.